

DCAA MEMORANDUM FOR REGIONAL DIRECTORS COVER SHEET
AUDIT GUIDANCE/MANAGEMENT MEMORANDUM NO. 96-PSP-200(R)

Date of MRD: 26 Dec 1996

Subject of MRD: Audit Guidance on the Review of Cost/Benefit Analyses Submitted Under the
Single Process Initiative

Current Audit Guidance and/or Audit Management Guidance Affected:

Paragraph	CAM Explanation of Effect on Current Version of CAM
None	

Type of Report	Pro Forma Document Name	Step No.	STANDARD AUDIT PROGRAMS Explanation of Effect on Current Audit Program
None			

Type of Report	Pro Forma Document Name	Sec/Par.	PRO FORMA AUDIT REPORTS Explanation of Effect on Current Audit Report
None			

MRD No.	Date	MEMORANDUMS FOR REGIONAL DIRECTORS Subject/Explanation of Change
None		

ICQ or VAP	Section & No.	INTERNAL CONTROL QUESTIONNAIRE/VULNERABILITY ASSESSMENT PROCEDURES State Control(s) Affected by the Change
None		

DCAAP/RI/No.	Date	Page/Sec/Par	DCAA PAMPHLETS/REGULATIONS/INSTRUCTIONS Explanation of Effect
None			

POD/Man	Page/Sec/Par	PROGRAM OBJECTIVE DOCUMENT/FMIS USER MANUAL Explanation of Effect
	None	



IN REPLY REFER TO

DEFENSE CONTRACT AUDIT AGENCY
8725 JOHN J. KINGMAN ROAD, SUITE 2135
FORT BELVOIR, VA 22060-6219

26 December 1996

PSP 730.4.15

96-PSP-200(R)

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
DIRECTOR, FIELD DETACHMENT, DCAA

**SUBJECT: Audit Guidance on the Review of Cost/Benefit Analyses Submitted
Under the Single Process Initiative**

On 6 August 1996, we issued updated audit guidance on DCAA's participation in the single process initiative (reference 96-PSP-103(R)). That guidance:

- reemphasized earlier guidance
- discussed the Department's expectations for cost/benefit analysis submissions
- provided attributes for an adequate cost/benefit analysis
- provided reporting examples to assist the auditor in reporting on the cost/benefit analysis

The Defense Contract Management Command (DCMC) recently issued the enclosed 19 November 1996 memorandum on cost/benefit analysis expectations under the single process initiative (Enclosure 1). The DCMC memorandum emphasizes that the Department is expecting substantial savings from contractors' implementation of the single process initiative, and that the cost/benefit analysis should include an estimate of those savings. The DCMC memorandum also discusses the attributes of an adequate cost/benefit analysis and states that the DCAA should be requested to review the analysis. Cost/benefit analysis information will be included in future Contract Administration Offices' weekly reports to DCMC Headquarters.

Our recent assessment of DCAA reports on cost/benefit analysis shows that savings (especially future years' savings in forward pricing) included in the analyses has been relatively insignificant. The cost/benefit analysis should address the following items:

- estimated implementation costs
- estimated savings on existing contracts
- estimated annual future savings to reflect in forward pricing

We have also developed general attributes for an adequate cost/benefit analysis. Enclosure 2 is a list of those attributes.

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When asked to review a cost/benefit analysis, the auditor should first determine if it includes all of the relevant implementation cost and savings information (instant savings on existing contracts and annual future savings impacting forward pricing) use the listing of attributes at Enclosure 2 as a guide. Also at the beginning of the review, the auditor should coordinate with the contracting officer to discuss the agreed-upon procedures and determine the customer's expectations.

The level of detail to support the cost/benefit analysis is dependent upon such items as:

- a. the technical complexity of the proposed change;
 - b. the government's participation in the contractor's implementation costs and savings;
- and
- c. the materiality of the estimated costs and savings.

If the cost/benefit analysis does not include all relevant items, the auditor should immediately conduct fact-finding with the contractor to obtain the information or the reasons why the information is not relevant. If the fact-finding does not result in obtaining the relevant implementation cost and savings information, request in writing the assistance of the administrative contracting officer in obtaining the necessary data.

The underlying concept of the block change process is that the cost/benefit analysis does not need to be supported by cost or pricing data. It is similar to the Cost Accounting Standards cost impact paper concept. If current savings significantly exceed implementation costs, cost or pricing data would be needed to make changes to existing contracts.

As management councils are formed to implement the single process initiative, the auditor should coordinate with the contractor and contracting officer to determine if the use of an integrated product team approach would be beneficial to prepare and review the cost/benefit analysis. Under this approach, the government provides the contractor with supporting data expectations and review criteria before the contractor starts to prepare the analysis. The contractor then submits parts of the cost/benefit analysis for government review as completed and approved by contractor management (examples of parts that could be submitted as they are completed include the implementation costs, savings on existing contracts, and annual future savings). The government then provides real-time feedback to the contractor on the review results. The integrated product team approach usually results in a better prepared cost/benefit analysis and significantly reduced review cycle time.

Our guidance issued on 6 August 1996 contains the report paragraph examples on the review of cost/benefit analyses. Enclosure 3 updates report examples to reflect the guidance contained in this memorandum and lessons learned since 6 August 1996. Please continue to provide Headquarters with a copy of reports on cost/benefit analyses (Attention: PSP). This helps us to identify issues that may require additional guidance.

PSP 730.4.15

SUBJECT: Audit Guidance on the Review of Cost/Benefit Analyses Submitted
Under the Single Process Initiative

Please direct any questions or comments to the Headquarters, Special Projects Hotline, at
(703) 767-3290, fax at (703) 767-3234 or cc:Mail at *PSP.

/Signed/

Lawrence P. Uhlfelder
Assistant Director
Policy and Plans

Enclosures

1. DCMC Memorandum, dated 19 November 1996
2. Cost/Benefit Analysis Recommended Guidelines
3. Agreed-upon Procedures Reporting Examples

DISTRIBUTION: C



DEFENSE LOGISTICS AGENCY
THE DEFENSE CONTRACT MANAGEMENT COMMAND
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IN REPLY
REFER TO AQOC

NOV 19 1996

MEMORANDUM FOR COMMANDERS, DEFENSE CONTRACT MANAGEMENT
DISTRICTS

SUBJECT: Single Process Initiative (SPI) -- Cost Benefit Analysis

The Department is expecting substantial savings from contractors' implementation of SPI. As such, one of the key elements of a contractor's concept paper is the inclusion of a rough order of magnitude cost benefit analysis.

It is the responsibility of the Administrative Contracting Officer (ACO) to ensure that the cost benefit analysis is adequate. This means that the analysis is based upon empirical data; that it includes the major activities needed to implement the process, and an estimated cost for each; and that it identifies those requirements to be deleted along with an estimated annual saving to both existing and future contracts. The cognizant Defense Contract Audit Agency (DCAA) field office should be requested to analyze the cost benefit analysis and provide advice as to its reasonableness. As always, ACOS should continue to use sound business judgment in arriving at their decisions.

To better posture ourselves for questions in this area, Contract Administration Offices should begin reporting in their weekly reports, the contractor's estimated cost to implement the proposed process change and their estimate of annual savings and avoidances to both existing and future contracts. I also want included in the report, those estimates arrived at by DCAA and their rationale for any differences.

Questions on this matter should be directed to Ms Marialane Schultz, my SPI Team Leader. She can be reached on (703) 767-2471, DSN 427-2471, or via the internet at marialane_schultz@hq.dla.mil.

/s/

ROBERT W. DREWES
Major General, USAF
Commander

ENCLOSURE 1

Cost Benefit Analysis - Recommended Guidelines

1. The cost/benefit analysis should include an analysis of:
 - Implementation costs,
 - Estimated savings on existing contracts, and
 - Estimated annual future savings to reflect in forward pricing.
2. The annual future savings should be forecasted for the period covered by the contractor's indirect expense rate forecast (usually five years).
3. The cost/benefit analysis should identify both direct and indirect implementation costs and savings. Estimated implementation costs and savings should be broken down by the contractor's normal direct and indirect cost elements.
 - Direct implementation costs and savings to be included in contract price proposals
 - Indirect implementation costs and savings to be included in forward pricing rates.
4. There should be rationale to support significant estimates of implementation costs and savings. For example, the analysis should identify the implementation plan and procedures, and the related costs. The major implementation cost items should include estimating rationale. The analysis should also identify the changed (deleted and new) requirements as a result of implementation of the single process initiative, and the related savings. The savings should be broken out by savings on existing contracts and annual savings after implementation. The major savings' areas should include estimating rationale.
5. The cost/benefit analysis should identify recurring versus non-recurring implementation costs and savings.

Note: The level of detail required is dependent upon the circumstances. Consider such items as technical complexity, government participation, and the materiality of estimated implementation costs and savings. More significant changes would usually require more supporting data. Parametrics and information other than historical data may be used to support the estimates, if appropriate.

EXAMPLES OF AGREED-UPON PROCEDURES REPORT FORMAT

SUBJECT

As requested by DCMC-Alexandria on December 4, 1996, we applied agreed-upon procedures to review the cost/benefit analysis within the concept paper submitted by ABC Company on December 2, 1996. ABC Company proposes in the concept paper to replace several software development military standards and specifications (DoD Standards 2167A and 2168, and MIL Standards 1521B and 1803) on existing contracts with a single process for software development. The new single process will eliminate the requirement for providing paper copies of in-process software code to the program offices each quarter. Instead, program offices will be provided on-line, real-time access to the software code as it is developed.

ABC Company estimates that it will cost \$1,350,000 to implement the new process. ABC Company also estimates that the new process will result in savings (net of implementation costs) on existing contracts of \$1,400,000. For future contracts, annual savings of \$12,000,000 are expected beginning in fiscal year 1997.

SCOPE

As requested, we applied procedures to review the overall reasonableness of the cost/benefit analysis, including ABC Company's single process implementation plans and procedures and associated costs, and identification of changed (deleted and new) requirements and related savings estimates. We also applied procedures to review ABC Company's estimate of savings on existing contracts, and annual future savings that will be reflected in the contractor's forward pricing, if the new process is approved. These procedures were coordinated with your office on December 6, 1996. Due to the limited information included in the cost/benefit analysis, we did not perform the customary auditing procedures necessary to constitute an examination made in accordance with generally accepted government auditing standards.

RESULTS

(First Example - No Exceptions)

The cost/benefit analysis includes a reasonable general dollar magnitude estimate of implementation costs and related savings.

(Second Example - Savings Understated And Implementation Costs Overstated)

In connection with the application of the agreed-upon procedures, we found that the implementation costs were overstated by \$500,000. ABC Company included implementation costs of \$500,000 to purchase additional computer hardware to provide on-line access to in-process software development. We found that existing hardware is sufficient to provide the on-line access. ABC Company agrees and will revise its cost/benefit analysis.

We also found that annual future savings were understated by \$7,500,000. ABC Company did not include the savings for all anticipated contracts in the estimate. ABC Company agrees and will revise its cost/benefit analysis.

(Third Example - Contractor Did Not Prepare An Estimate Of Long-Term Savings To Include In Forward Pricing)

The cost/benefit analysis includes a reasonable general dollar magnitude estimate of implementation costs and savings on existing contracts. However, the contractor did not prepare an estimate of future savings to include in forward pricing proposals. ABC Company initially said that the estimate of future savings will be prepared at a later date when better information is available. We recommended that ABC Company prepare a general dollar magnitude estimate of future savings based on existing information to provide for timely incorporation into the forward pricing after the single process has been approved. This estimate will also help the government to assess the overall savings from implementing the new process. ABC Company now agrees to prepare an estimate of future savings to reflect in forward pricing and will provide that estimate by January 7, 1997.

(Fourth Example - Implementation Costs Exceed Savings)

The cost/benefit analysis includes a reasonable general dollar magnitude estimate of implementation costs and savings. However, implementation costs exceed potential savings by a significant amount. We recommend that the contractor provide sufficient rationale to justify the government accepting a process change that will result in increased costs. ABC Company says that the new process will substantially increase the quality of its software development process and will provide supporting data to your technical staff by January 7, 1997.

(Concluding Paragraph - All Examples)

This report pertains only to the application of agreed-upon procedures to review the contractor's cost/benefit analysis. These procedures do not constitute an audit conducted in accordance with generally accepted government auditing standards.